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ABSTRACT

A study was done of how the College Construction Loan Insurance Association (Connie Lee) carried out its mission, particularly in its service to the 102 Historically Black Colleges and Universities (HBCU). The study interviewed officials at Connie Lee, HBCUs and other schools, the Department of Education, and representatives of the bond insurance industry. It also collected data on the colleges, universities, and teaching hospitals that were either approved or rejected for bond insurance between 1991 and 1995, and examined information on Connie Lee's financial record and profitability through 1994. The study found that from 1991 to 1995 at least 23 HBCUs requested insurance for 25 bonds of which Connie Lee offered to insure 8, declined to insure 3, and determined that 13 were rated above the category of risk that Connie Lee was authorized to insure (Connie Lee had not yet decided on one bond). The review concluded that Connie Lee itself, federal and state law, and industry practice, all limited it to insuring bonds issued by a narrow range of schools. Also some schools, including HBCUs, did not need or want to issue bonds or to insure bonds, and others found the cost or the debt incurred in issuing bonds impractical. Appendixes contain a list of HBCUs, Connie Lee financial information, methodology information, and Department of Education comments. (JB)

United States General Accounting Office

GAO

Report to the Ranking Minority Member, Committee on Economic and Educational Opportunities, House of Representatives

cember 1995

FINANCING COLLEGE FACILITIES

Factors Limit Connie Lee's Ability to Help More Schools

GAO/HEHS-96-6

GAO

United States
General Accounting Office
Washington, D.C. 20548

Health, Education, and
Human Services Division

B-260631

December 8, 1995

The Honorable William L. Clay
Ranking Minority Member
Committee on Economic and
Educational Opportunities
House of Representatives

Dear Mr. Clay:

The College Construction Loan Insurance Association (Connie Lee), is a for-profit bond insurance holding company that is authorized by federal statute and owned by stockholders, including the Department of Education. Established under the Higher Education Amendments of 1986, Connie Lee primarily insures municipal bonds issued by schools of higher education—colleges, universities, and teaching hospitals—that have difficulty obtaining such insurance, that is, those schools whose bonds have relatively low credit ratings—BBB and below.[1] Connie Lee insures bonds issued by these schools to finance the construction and renovation of academic facilities. Like other private municipal bond insurers, Connie Lee is regulated by the states in which it operates and heavily influenced by industry practice.

You asked us to provide you with information on how Connie Lee has carried out its mission, especially for the 102 Historically Black Colleges and Universities (HBCU) (see app. I for a listing of these schools).[2] More specifically, in this report we describe (1) the extent to which Connie Lee has served the needs of schools of higher education, especially HBCUs, by insuring municipal bonds issued to finance the construction and renovation of academic facilities; (2) the reasons why Connie Lee has not insured bonds for more schools; (3) HBCUs' views on alternatives to Connie Lee for financing construction and renovation projects; and (4) Connie Lee's views on changes to Connie Lee that might enable it to better serve HBCUs. In addition, we agreed to describe Connie Lee's financial record and profitability. This information, which shows Connie Lee to be in sound financial condition, is provided in appendix II.[3]

[1] Bond credit ratings are based on the issuer's ability to make interest payments and repay principal as scheduled. Bonds rated BBB and above are considered investment grade bonds, those rated below BBB are considered noninvestment grade bonds.

[2] HBCUs are accredited colleges and universities established before 1964 whose primary mission is educating black Americans.

[3] This assessment is based on an evaluation by Standard and Poor's Corporation, a national credit rating firm.

To develop information for this report, we interviewed officials at Connie Lee, HBCUs and other schools, the Department of Education, and representatives of the bond insurance industry. We collected data on the colleges, universities, and teaching hospitals that were either approved or rejected—from October 29, 1991, through September 30, 1995—by Connie Lee for bond insurance. In addition, we obtained information on Connie Lee's financial record and profitability through 1994. We did not independently verify the accuracy of the information provided to us. Our work was conducted between March 1994 and October 1995 in accordance with generally accepted government auditing standards. (See app. III for more information on our scope and methodology.)

Results in Brief

From October 1991—when Connie Lee insured its first bond—through September 1995, Connie Lee insured 95 bonds totaling about $2.6 billion, of which 90 were rated BBB and 5 were rated A or above, and declined to insure 406 other bonds because it considered them to be too great a credit risk. As of September 30, 1995, 17 schools were considering Connie Lee's offer of insurance.

During this same period, at least 23 HBCUs approached Connie Lee about obtaining insurance for 25 bonds. For these HBCUs, as of September 30, 1995, Connie Lee offered to insure 8 bonds; declined to insure 3 bonds it considered a credit risk; determined that 13 were rated above the category of risk that, at the time the schools applied, Connie Lee was authorized to insure; and had not decided whether to offer insurance for 1 bond. Of the eight bonds that Connie Lee offered to insure, one was issued with Connie Lee insurance. For the other seven bonds, two HBCUs were considering Connie Lee's offer and five had issued the bonds without insurance or insured with another company.

Connie Lee's ability to insure municipal bonds for a broader range of schools is limited by federal law, which requires Connie Lee to insure bonds generally rated BBB or below; state laws that require Connie Lee to have 95 percent of its business in bonds rated BBB and above; and industry practice, which discourages bond insurers from insuring bonds rated below BBB—"noninvestment grade." In addition, there are many schools that Connie Lee cannot serve because they have no need for bond insurance. Furthermore, some schools, especially small schools like many HBCUs, find that the cost of issuing a bond and the size of the debt incurred make issuing a bond impractical.

HBCU officials said that to meet their financing needs for academic facilities, HBCUs have alternatives to Connie Lee's bond insurance. For example, some HBCUs may be able to (1) finance the construction and renovation of their facilities by issuing bonds without insurance; (2) obtain bond insurance from companies other than Connie Lee; or (3) finance construction and renovation using means other than bonds, such as grants or loans from federal and state governments, bank loans, or alumni and private foundation donations. For example, HBCUs may obtain federal loans through the Department of Education's recently implemented HBCU Capital Financing program.

Connie Lee officials suggested federal legislative actions that would enable Connie Lee to insure bonds for more schools, including HBCUs, than it is now serving: (1) remove the federal limits on the types of bonds and the credit rating of bonds that Connie Lee may insure; (2) guarantee that, should it be needed, the federal government would lend Connie Lee funds to pay claims on defaulted bonds; and (3) provide Connie Lee additional capital through loans or grants. In addition, Connie Lee suggested the need for authorization to borrow money from the federal government to make loans to small, low-rated—especially noninvestment grade—schools that cannot issue bonds or that are unable to obtain bond insurance. Although each of these actions may have its disadvantages and advantages, we did not assess their feasibility or the need for them because that was not within the scope of our review. We recognize, however, that they could increase federal costs and contingent financial liability.

Background

The nation's 3,600 colleges, universities, and teaching hospitals continually need to construct new facilities or renovate obsolete or aging facilities. While it has been long recognized that replacing or repairing facilities is a critical problem for these schools, there are no reliable data on the extent of needed construction and renovation. Connie Lee estimates that more than $100 billion will be required during this decade to meet the need.

In the 1980s, federal support of academic facilities in the form of grants and loans to schools of higher education was cut drastically. Alternative financing means such as internal funding, fund raising campaigns, and bank financing options generally were inadequate for significant construction and renovation projects. Issuing municipal bonds to finance such projects was limited mostly to schools with the highest credit standing. To help fundamentally sound but less creditworthy schools issue bonds to finance needed facilities projects, in 1986 the Congress established a college construction loan insurance corporation—Connie Lee.

Municipal Bonds

Municipal bonds are debt securities (long-term loans) that issuers (borrowers) sell to investors (lenders) so they can finance public projects—such as roads, airports, and public college facilities—and certain kinds of private projects—such as private college and hospital facilities—deemed to be serving public purposes. Municipal bonds may also be used to refinance existing debt. For the use of investors' money, issuers promise to pay investors interest on specific dates and to repay the amount borrowed (principal) on a specific date or dates. Municipal bonds are issued through state and local government agencies. Repayment periods typically are 20 to 30 years.

Municipal bonds are typically divided into two categories: general obligation bonds and revenue bonds. General obligation bonds usually finance public projects and are backed by the taxing authority of the state or local government that issues the bonds; the principal and interest are paid from tax receipts. The principal and interest on revenue bonds, by contrast, are generally paid from income (revenues) produced by the project that the bonds finance. For example, the principal and interest on a revenue bond issued to finance a college dormitory would be paid from fees collected from residents of the dormitory.

Some municipal bonds issued to finance public projects may not be funded from state appropriations. In some states, for example, bonds issued by public colleges and universities for dormitory projects do not qualify for state backing. In these states, public schools may issue revenue bonds to finance the construction or renovation of dormitories.

The interest income from municipal bonds is generally exempt from both federal income tax and state and local taxes of the state in which the bonds are issued. Because investors receive tax-free interest, they may be willing to purchase bonds that have a lower interest rate than they would otherwise require. The ability to issue tax-exempt bonds at lower interest rates may substantially reduce the issuer's costs.

Credit Quality of a Bond

To make its bonds appealing to investors, an issuer may obtain a credit rating for its bonds from a nationally recognized credit rating firm. These firms independently assess issuers' ability to make scheduled interest and principal payments when they are due. The firms assign credit ratings to bonds as a gauge of the risk of default—nonpayment of interest or principal.

Standard and Poor's Corporation, for example, assigns ratings ranging from AAA, for the highest quality bonds, to D, for the lowest quality. Standard and Poor's refers to bonds rated in its top four categories—AAA, AA, A, and BBB—as "investment grade" bonds. They are judged to have a high probability of on-time interest and principal payments and little risk of default. Bonds rated in categories BB to C, commonly called "junk bonds," are referred to by Standard and Poor's as "noninvestment" or "speculative" grade. They are considered to have a higher risk of default. Bonds rated D are in default with respect to principal or interest payments. Other credit rating firms use similar rating categories.

Credit rating firms generally consider revenue bonds to have a higher risk of nonpayment than general obligation bonds because revenue bonds are not backed by the taxing authority of the state or local government and usually depend on the project funded to produce sufficient revenues to make interest and principal payments when due. In addition, Standard and Poor's generally considers hospitals and private colleges and universities to be among the relatively riskier categories of institutions that issue municipal bonds. Private schools lack the backing of any taxing authority, and some of these schools have limited resources. The health care industry, in general, is viewed as having an uncertain future.

To enhance a bond's credit quality, an issuer may purchase insurance for its bond. Through such insurance, an insurer guarantees investors that it will pay the bond interest and principal when due if the issuer defaults. Rating firms that rate bonds also rate bond insurance companies on their ability to pay claims for defaulted interest or principal payments. Consequently, insured bonds are issued with the rating of the insurer rather than the rating of the issuer. Enhancing the quality of a bond in this manner may persuade investors to accept lower interest rates than they might otherwise. The lower interest cost may more than offset the cost to the issuer of obtaining insurance.

Rating firms use a variety of criteria to evaluate the creditworthiness of bond insurers. They are judged on capital adequacy, which is the amount of capital they have relative to the amount of debt they have insured; their management experience; their underwriting policies; their financial performance; and other organizational factors. The key area in the assessment, however, is capital adequacy. Since its credit rating is the commodity that the bond insurer sells, the performance guidelines established by firms that rate it exert a considerable influence on its business practices.

According to Standard and Poor's, there are 10 major municipal bond insurance companies in the United States, including Connie Lee, which is one of the newest and smallest of the 10 companies. Nine of the companies, including Connie Lee, are rated AAA by one or more of the major rating firms. The one exception has a AA rating. The municipal bond insurance market is dominated by three insurers that have captured more than 90 percent of the bond insurance market. In 1994, insured municipal bonds totaled about $61 billion, about 37 percent of all municipal bonds that were issued. Connie Lee has approximately a 1-percent share of the overall municipal bond insurance market. It is the only major municipal bond insurance company exclusively insuring schools of higher education. Over the past 3 years, it has insured more BBB schools than any other major municipal bond insurance company.

The Mission of Connie Lee

The Congress amended the Higher Education Act in 1986 to establish Connie Lee. The Congress was concerned that there were many fundamentally sound but less creditworthy schools of higher education unable to obtain bond insurance at a reasonable cost, thereby preventing them from issuing municipal bonds to finance needed facilities construction and renovation projects. Connie Lee is authorized to insure municipal bonds rated by a national rating firm at or below the lowest investment grade category—the equivalent of Standard and Poor's BBB and below ratings—issued by schools of higher education; the proceeds of these bonds are to be used to finance the construction and renovation of academic facilities. In 1992, the Congress further amended the act to allow Connie Lee to insure a limited volume of higher rated bonds through calendar year 1997 on the condition that other municipal bond insurance companies declined to insure the bonds.

Under the 1986 amendments, Connie Lee was incorporated in February 1987 as a bond insurance holding company. During 1987 and 1988, Connie Lee sold stock to the Department of Education and the Student Loan Marketing Association (Sallie Mae) and, in 1991, to a group of private investors.[4] Currently, Education owns about 14 percent of Connie Lee's stock, Sallie Mae owns about 36 percent; and the other stockholders own about 50 percent. Under the act, Connie Lee is managed by an 11-member board of directors: 3 appointed by Sallie Mae, 2 appointed by the Secretary of Education, 2 appointed by the Secretary of the Treasury, and 4 elected by the private stockholders.

In December 1987, Connie Lee purchased an existing insurance company, which it renamed the Connie Lee Insurance Company, to carry out its insurance operations. It began insurance operations as a bond reinsurer in December 1988, when it received from Standard and Poor's a AAA rating as a bond reinsurer.[5] It began operating as a primary insurer in October 1991 when it received from Standard and Poor's a AAA rating as a primary insurer. The Connie Lee Insurance Company is authorized to operate in 49 states, the District of Columbia, and Puerto Rico.

As of October 1995, proposed legislation under consideration by the Congress would sever Connie Lee's relationship with the federal government, a process commonly referred to as "privatization." If enacted, such legislation could change the way in which Connie Lee operates and could affect the types of projects it insures.

Connie Lee Primarily Insures the Lowest Investment Grade Bonds

Between October 29, 1991, the date Connie Lee sold its first primary insurance, and September 30, 1995, Connie Lee insured 95 bonds, totaling about $2.6 billion, for colleges, universities, and teaching hospitals. Of these, 90 were rated BBB, the lowest investment grade rating, and 5 were rated A or better. None was noninvestment grade at the time it was insured; that is, none was rated below BBB, although several have subsequently received ratings in the noninvestment grade category. Almost all were revenue bonds.

The five bonds rated A or better were insured after the Higher Education Amendments of 1992. According to Connie Lee officials, each bond was refused insurance by other insurance companies before Connie Lee agreed to insure it, in accordance with the 1992 amendments. The bonds did not

[4]Sallie Mae—a stockholder-owned, for-profit enterprise established by the Congress in 1972 as a national secondary market for federally guaranteed student loans—is authorized to make loans to schools of higher education and to buy and sell obligations, including bonds, issued by these schools to finance academic facilities

[5]Reinsurance is insurance coverage purchased by an insurer from another insurer to spread the risks incurred

exceed the limits on the amount of A-rated business imposed on Connie Lee by the act, as amended.

In addition to the 95 bonds that Connie Lee insured, at the end of September 1995, 17 schools were considering whether to accept Connie Lee's offer of insurance.

As of September 30, 1995, Connie Lee had declined to insure 406 bonds because of concerns it had about the schools' ability to repay bond principal and make interest payments as scheduled. It had also rejected an undetermined number of bonds for insurance because the bonds' credit ratings were A or better. Data are not available on those applications for insurance because Connie Lee does not maintain such data.

Connie Lee Insurance Activity With HBCUs

Since October 1991, at least 23 HBCUs have approached Connie Lee about obtaining bond insurance for 25 bonds. As of September 30, 1995, Connie Lee had insured only one bond for an HBCU—a BBB-rated $2.2 million bond insured in July 1994 for a 4-year public university. Standard and Poor's has since downgraded that bond into the noninvestment grade category. As of September 30, 1995, this school was continuing discussions with Connie Lee about insuring a second bond, but Connie Lee had not decided whether to offer insurance for the bond.

In addition to the bond it insured, Connie Lee offered to insure seven other bonds for HBCUs. As of September 30, 1995, two HBCUs were considering whether to accept Connie Lee's offers. The remaining five HBCUs did not accept Connie Lee's offers. Three of the five schools purchased insurance from other companies, whose premiums were lower than Connie Lee's, school officials said. Another school had no record of Connie Lee's having quoted a rate to them; it purchased insurance from another company, the school said. The fifth school had issued its bond without insurance and Sallie Mae had bought the bond issue, school officials said.

Connie Lee did not insure bonds for at least 16 HBCUs that applied. It declined to insure three bonds because of concerns about the schools' credit status. Although data are not available, Connie Lee estimated that it turned down at least 13 HBCUs because the schools' A or better rating made them ineligible for insurance. At the time, federal law limited Connie Lee to insuring bonds rated BBB or below.

At two of the three HBCUs that Connie Lee declined to insure, school officials said the schools were denied insurance because Connie Lee believed their student loan default rates were too high. One of the two schools reported on its application to Connie Lee that its default rates in fiscal years 1989, 1990, and 1991 were 27 percent, 32 percent, and 25 percent, respectively, officials of this school said. The second school's rates, as reported to Connie Lee, were 25 percent, 32 percent, and 18 percent for the same 3 years, this school said. The third school was unable to provide us with information about why it was denied insurance. Those who had filed the application were no longer at the school and no record of it could be located, according to school officials. Connie Lee offered to insure a second bond for this school; it is one of the two HBCUs that, as of September 30, 1995, was considering whether to accept Connie Lee's offer of insurance.

According to Connie Lee, a school's Federal Family Education Loan Program (FFELP) (formerly the Guaranteed Student Loan Program) default rate is a critical element in Connie Lee's decision whether to insure a bond for the school. Connie Lee believes that private schools that rely on funds provided by student loans for a significant portion of their revenues and also have high student loan default rates are at greater risk of defaulting on bond interest and principal payments.

The Department of Education uses a school's student loan default rate to determine the school's eligibility to participate in FFELP. In 1990, the Congress established a process that Education can use to bar schools with high student loan default rates from continuing to participate in FFELP. Each year, Education assesses a school's eligibility, which is based on that school's three most recent available annual loan default rates. To remain eligible, a school's default rate must be below the statutory threshold in at least 1 of the last 3 consecutive fiscal years. The threshold for determining a school's eligibility was 35 percent in fiscal years 1991 and 1992 and 30 percent in 1993. Beginning in fiscal year 1994, the threshold has been 25 percent. HBCUs are exempt from the default rate eligibility requirements until July 1, 1998.

Reasons Why Connie Lee Has Not Insured Bonds for More Schools

There are several reasons why some colleges, universities, and teaching hospitals have not obtained bond insurance from Connie Lee. Federal and state law and industry practices impose limits on Connie Lee. In addition, for many schools, bonds or bond insurance is unnecessary or unsuitable.

Federal Law Limits Connie Lee to Insuring Lower-Rated Bonds

Federal law limits Connie Lee to a defined sector of the bond market: bonds generally rated BBB and below, issued by colleges, universities, and teaching hospitals, to finance academic facilities. Many schools, however, are financially strong. If they issue bonds, their bonds most likely would be rated above BBB. In addition, public schools' bonds that are fully or partially backed by the state in which they are located are usually rated A or better because of the state's A or better rating. Connie Lee generally is unable to insure bonds rated A or better.

State Law Limits Connie Lee to Insuring Investment Grade Bonds

States require municipal bond insurance companies that operate in them, including Connie Lee, to have a specified percentage of their business in investment grade categories, that is, bonds rated BBB or above. In effect, the highest percentage required by any state in which a company operates sets the minimum standard for the company for all states in which it operates. Because two states in which Connie Lee operates require bond insurance companies to have 95 percent of their business in the investment grade categories, Connie Lee must meet this 95-percent standard in all jurisdictions in which it operates.

Industry Practices Limit Connie Lee to Insuring Higher-Rated Bonds

As previously discussed, credit rating firms, because they determine the rating that a bond insurance company can confer on bonds, have influence over the business practices of bond insurers. Credit rating firms' guidelines effectively restrict the amount of noninvestment grade business an insurer can have and still maintain its rating. For example, under Standard and Poor's guidelines, Connie Lee, as well as the other bond insurance companies it rates, should have at least 50 percent more capital for any noninvestment grade business than for investment grade business.

Issuing and Insuring Bonds Unnecessary or Unsuitable for Many Schools

Many colleges, universities, and teaching hospitals do not need to issue bonds or obtain bond insurance. In some states, public schools receive funds from the state for the construction and renovation of facilities. In addition, some public and private schools receive funds for capital projects from other sources, such as endowments. Consequently, these schools may not have to incur debt to finance the cost of capital projects. Furthermore, some schools are fiscally conservative, preferring to save for projects rather than incur debt.

However, schools that consider issuing a bond must take into account such critical factors as the size of the debt to be incurred and the costs to issue a bond. Generally, it is not cost-effective to issue bonds of less than $4 million, according to Connie Lee. Costs—such as fees for financial advisers, underwriters, attorneys, credit rating firms, brokers, and others; and insurance premiums—can add substantially to the total cost of a bond. Many schools, especially small schools, either (1) do not need facilities costing millions of dollars or (2) are unwilling or unable to take on debt of that magnitude or to commit to repayment periods of 20 to 30 years. These schools may be able to obtain financing from sources such as bank loans.

In addition, the credit rating of a bond may influence a school's decision about whether to issue a bond and, if so, whether to insure it. Schools whose bonds would be rated BBB or lower may decide not to issue the bonds because the interest rates and insurance costs may be too high. On the other hand, schools, regardless of their credit ratings, may decide to issue bonds without insurance because they believe that the bonds would sell without the enhancement of insurance.

Financing HBCUs' Construction and Renovation Projects Without Connie Lee Insurance

Issuing a bond insured by Connie Lee is just one way to finance the construction and renovation costs of HBCUs' academic facilities. Like non-HBCU schools, not all HBCUs need to, can, or want to issue bonds, and not all HBCUs that issue bonds need to, or can, obtain bond insurance from Connie Lee. HBCU officials described other ways in which the schools can finance their projects.

Issuing Bonds Without Connie Lee Insurance

Some HBCUs may issue bonds without insuring them, and some may be able to obtain bond insurance from companies other than Connie Lee. Public schools located in states with an A or better credit rating may issue bonds that have the same rating as their states. Because the 49 public HBCUs, except for one located in the District of Columbia, are located in states with an A or better rating, they may be able to issue bonds that are rated A or better. Financially strong private HBCUs also may be able to issue bonds rated A or better. However, if these schools issue bonds that are rated A or better, they may decide to issue them without obtaining insurance. As discussed earlier, one HBCU that Connie Lee offered to insure issued its bond without insurance, and four obtained insurance from other companies.

Financing Projects Without Bonds

As discussed earlier with respect to all schools, some HBCUs, especially small schools, either do not need multimillion-dollar facilities or are unwilling or unable to take on the large debt to finance them. Of the 102 HBCUs, 53 had an enrollment in 1993 of less than 2,000 students. Some HBCUs traditionally do not issue debt securities to finance capital projects because their managers are fiscally conservative. Typically, these HBCUs attempt to raise needed funds from alumni and friends rather than incur debt. Other HBCUs use these and other means to finance their projects: Federal and state governments, banks, and private foundations and companies make funds available to HBCUs for various purposes, including funding construction and renovation projects.

For example, 27 federal departments and agencies support HBCUs to some extent. Federal programs provide funds to HBCUs for administration; research and development; faculty development; student tuition assistance; and the acquisition, construction, maintenance, and renovation of facilities and equipment. Specifically, the Department of Education provides money for HBCUs through several grant programs.[6] For example, the Strengthening HBCUs Program provides for a $500,000 minimum allotment for each of its grant recipients. Through another program, the Department of the Interior's National Park Service maintains part of the campus of Tuskegee University, a private school, because it has been designated a national historic site. Tuskegee recently received $14 million from the Park Service to renovate four buildings. Tuskegee also receives financial support from the state of Alabama; it received about $3 million in 1994.

The United Negro College Fund, a consortium of 41 private HBCUs, is a private foundation that provides funds to member HBCUs. Since its inception in 1944, it has raised nearly $1 billion for its members. The schools may use the funds for scholarships, program and faculty development, administration, endowments, and facilities construction and renovation. Also, Sallie Mae financed in fiscal year 1994 construction projects totaling about $343 million at colleges, universities, and teaching hospitals, including HBCUs.

Education's HBCU Capital Financing program—authorized in 1992 to finance the construction and renovation of educational facilities at HBCUs—is a more appropriate vehicle than Connie Lee to serve schools with characteristics such as small size and limited resources that many HBCUs share, a number of those that we interviewed at HBCUs and at Education suggested. The program is just getting under way. The Secretary

[6]These include the Strengthening HBCUs, Strengthening Historically Black Graduate Institutions, and Endowment Challenge Grants programs authorized by the Higher Education Act, as amended.

of Education has selected a private, for-profit corporation to issue bonds, the proceeds of which will be loaned to eligible HBCUs for construction projects. The corporation will issue approximately $357 million in bonds in 1995, Education estimates, and expects to make the first loans before December 31, 1995. Eligibility for the loan program is based on criteria that Education and the corporation developed.

Connie Lee's Suggestions for Better Serving Targeted Schools

Connie Lee officials suggested several federal legislative actions that they said would help Connie Lee serve a broader range of schools, including HBCUs, targeted by its mission. For example, officials suggested that limits in federal law that restrict Connie Lee to (1) serving only schools of higher education and (2) insuring primarily bonds rated BBB and below could be removed. This would permit Connie Lee to operate the way other bond insurance companies operate; that is, to diversify its business by insuring bonds of other types of issuers and to balance the lower-rated bonds it insures by also insuring higher-rated bonds.

Giving Connie Lee authority to borrow money from the federal government, as needed, to pay claims on defaulted bonds that it insured is another suggestion that Connie Lee officials offered. This could be accomplished by giving Connie Lee a direct line of credit with the U.S. Treasury or allowing it to borrow from Treasury's Federal Financing Bank.[7] In effect, this would be a federal guaranty—a federal reinsurance of Connie Lee—that could be made applicable only to bonds rated below BBB. The guaranty could be administered by Connie Lee through a separate subsidiary company, unrelated to the Connie Lee Insurance Company, that would not be subject to state insurance requirements. Structuring support in this way would preclude Connie Lee from violating state licensing requirements for the proportion of debt it insures that must be investment grade, Connie Lee officials suggested.

A one-time federal subsidy for Connie Lee was yet another suggestion. Although Connie Lee currently has sufficient capital to continue insuring only BBB-rated bonds, it would need considerably more capital to insure bonds rated below BBB, its officials said. This is because of Standard and Poor's high capital requirements for insuring noninvestment grade issues. A federal subsidy might take the form of a low-interest loan or a grant to Connie Lee, Connie Lee officials said.

[7]The Federal Financing Bank was created to ensure the coordination of federal and federally assisted borrowing from the public, and has been the vehicle through which most federal agencies finance their programs involving the sale or placement of credit market instruments.

Allowing Connie Lee to make loans to schools that usually cannot issue bonds or that are unable to obtain bond insurance because their bonds would be relatively low rated was also suggested. Connie Lee would borrow money from the Treasury or the Federal Financing Bank to make loans to schools whose bonds would be rated BBB, but especially to those that would be noninvestment grade, they said. This would be a new line of business for Connie Lee and could be administered apart from its bond insurance business through a separate subsidiary company.

Connie Lee officials realized that their proposed actions would require federal legislation. While we recognize that each of these actions may have its disadvantages and advantages, we did not assess their feasibility or the need for them because this was not within the scope of our review. We recognize, however, that they could increase federal costs and contingent financial liability.

Conclusions

Connie Lee is limited to insuring bonds issued by a narrow range of schools. More specifically, federal law generally limits it to insuring bonds that are relatively greater credit risks, that is, bonds rated BBB or below. State law, however, constrains bond insurance companies, including Connie Lee, to insuring 95 percent of their business in bonds rated BBB and above. Industry practice further constrains these companies. Rating firms' guidelines require larger amounts of capital for insuring bonds rated below BBB than for insuring bonds rated BBB and above.

Among those schools that Connie Lee is permitted to serve, some—including some HBCUs—do not need or want to issue bonds or to insure the bonds that they issue. For example, some bonds that public schools issue do not need insurance because the bonds have the states' credit ratings; these high ratings reduce or eliminate the benefits of insurance. Some schools, both public and private, are fundamentally strong. They do not have to incur debt to finance their construction or renovation projects, or they can issue bonds without insurance. Yet other schools find the cost to issue bonds or the size of the debt incurred makes using bonds to finance a project impractical. Finally, some schools find alternative sources of financing available. For HBCUs, for example, the Department of Education's recently implemented HBCU Capital Financing program is such an alternative.

Connie Lee and Department of Education Comments and Our Evaluation

Connie Lee and the Department of Education commented on a draft of this report. Connie Lee provided us with information to update and clarify the report, and we incorporated its comments as appropriate. Education did not disagree with our facts. Instead, it chose to state its support for privatizing Connie Lee. It also highlighted programs it administers that provide HBCUs funds for constructing and renovating academic facilities. These programs are noted in our report. (See app. IV.)

We will send copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs, the Senate Committee on Labor and Human Resources, the House Committee on Economic and Educational Opportunities, and the House Committee on Government Reform and Oversight; the Secretary of Education; the President of Connie Lee; and other interested parties. We will make copies available to others on request.

If you or your staff have any questions about this report, please call me or Joseph J. Eglin, Jr., Assistant Director, at (202) 512-7014. Major contributors to this report include John T. Carney, Sheila R. Nicholson, and Laurel H. Rabin.

Sincerely yours,

Cornelia M. Blanchette

Cornelia M. Blanchette
Associate Director, Education and
Employment Issues

Contents

Abbreviations

FFELP	Federal Family Education Loan Program
HBCU	Historically Black Colleges and Universities

Historically Black Colleges and Universities

HBCU	State	Institution type	Enrollment 1993
Alabama A&M University	AL	4-yr., public	5,593
Alabama State University	AL	4-yr., public	5,608
Bishop State Community College	AL	2-yr., public	4,650
Concordia College	AL	2-yr., private	387
Fredd State Technical College	AL	2-yr., public	241
J.F. Drake State Technical College	AL	2-yr., public	825
Lawson State Community College	AL	2-yr., public	2,307
Miles College	AL	4-yr., private	868
Oakwood College	AL	4-yr., private	1,451
Selma University	AL	4-yr., private	360
Stillman College	AL	4-yr., private	953
Talladega College	AL	4-yr., private	1,027
Trenholm State Technical College	AL	2-yr., public	945
Tuskegee University	AL	4-yr., private	3,371
Arkansas Baptist College	AR	4-yr., private	315
Philander Smith College	AR	4-yr., private	915
Shorter College	AR	2-yr., private	209
Univ. of Arkansas at Pine Bluff	AR	4-yr., public	4,075
Howard University	DC	4-yr., private	10,538
Univ. of the District of Columbia	DC	4-yr., public	10,608
Delaware State University	DE	4-yr., public	3,301
Bethune-Cookman College	FL	4-yr., private	2,210
Edward Waters College	FL	4-yr., private	786
Florida A&M University	FL	4-yr., public	9,876
Florida Memorial College	FL	4-yr., private	1,579
Albany State College	GA	4-yr., public	3,257
Clark Atlanta University	GA	4-yr., private	5,128
Fort Valley State College	GA	4-yr., public	2,743
Interdenominational Theological Center	GA	4-yr., private	374
Morehouse College	GA	4-yr., private	3,005
Morehouse School of Medicine	GA	4-yr., private	161
Morris Brown College	GA	4-yr., private	2,126
Paine College	GA	4-yr., private	723
Savannah State College	GA	4-yr., public	3,197
Spelman College	GA	4-yr., private	2,065
Kentucky State University	KY	4-yr., public	2,485
Dillard University	LA	4-yr., private	1,585
Grambling State University	LA	4-yr., public	7,833

(continued)

HBCU	State	Institution type	Enrollment 1993
Southern University and A&M College at Baton Rouge	LA	4-yr., public	9,502
Southern University at New Orleans	LA	4-yr., public	4,277
Southern University at Shreveport-Bossier City	LA	2-yr., public	1,083
Xavier University of Louisiana	LA	4-yr., private	3,391
Bowie State University	MD	4-yr , public	4,946
Coppin State College	MD	4-yr., public	3,265
Morgan State University	MD	4-yr., public	5,729
University of Maryland Eastern Shore	MD	4-yr , public	2,637
Lewis College of Business	MI	2-yr., private	262
Harris-Stowe State College	MO	4-yr., public	1,898
Lincoln University	MO	4-yr., public	3,623
Alcorn State University	MS	4-yr., public	2,712
Coahoma Community College	MS	2-yr., public	964
Jackson State University	MS	4-yr., public	6,346
Mary Holmes College	MS	2-yr., private	403
Mississippi Valley State University	MS	4-yr., public	2,330
Rust College	MS	4-yr., private	1,180
Tougaloo College	MS	4-yr., private	1,153
Barber-Scotia College	NC	4-yr., private	732
Bennett College	NC	4-yr., private	664
Elizabeth City State University	NC	4-yr., public	2,130
Fayetteville State University	NC	4-yr., public	4,032
Johnson C. Smith University	NC	4-yr., private	1,391
Livingstone College	NC	4-yr., private	704
North Carolina A&T State University	NC	4-yr., public	8,013
North Carolina Central University	NC	4-yr., public	5,645
Saint Augustine's College	NC	4-yr., private	1,745
Shaw University	NC	4-yr., private	2,504
Winston-Salem State University	NC	4-yr., public	2,909
Central State University	OH	4-yr., public	3,068
Wilberforce University	OH	4-yr., private	984
Langston University	OK	4-yr., public	3,439
Cheyney State University of Pennsylvania	PA	4-yr., public	1,519
Lincoln University	PA	4-yr., public	1,445
Allen University	SC	4-yr., private	290
Benedict College	SC	4-yr., private	1,266
Claflin College	SC	4 yr , private	972
Denmark Technical College	SC	2-yr , public	780

(continued)

HBCU	State	Institution type	Enrollment 1993
Morris College	SC	4-yr., private	938
South Carolina State University	SC	4-yr., public	4,779
Voorhees College	SC	4-yr., private	724
Fisk University	TN	4-yr., private	856
Knoxville College	TN	4-yr., private	846
Lane College	TN	4-yr., private	649
LeMoyne-Owen College	TN	4-yr., private	1,321
Meharry Medical College	TN	4-yr., private	697
Tennessee State University	TN	4-yr., public	7,851
Huston-Tillotson College	TX	4-yr., private	539
Jarvis Christian College	TX	4-yr., private	497
Paul Quinn College	TX	4-yr., private	670
Prairie View A&M University	TX	4-yr., public	5,848
Saint Phillip's College	TX	2-yr., public	6,732
Southwestern Christian College	TX	4-yr., private	182
Texas College	TX	4-yr., private	452
Texas Southern University	TX	4-yr., public	10,641
Wiley College	TX	4-yr., private	541
Hampton University	VA	4-yr., private	5,759
Norfolk State University	VA	4-yr., public	8,652
Saint Paul's College	VA	4-yr., private	672
Virginia State University	VA	4-yr., public	3,996
Virginia Union University	VA	4-yr., private	1,539
University of the Virgin Islands, St. Thomas Campus	VI	4-yr., public	1,867
Bluefield State College	WV	4-yr., public	2,601
West Virginia State University	WV	4-yr., public	4,756

Source: Department of Education data.

The College Construction Loan Insurance Association's Financial Record and Profitability

Connie Lee's financial record is sound, according to Standard and Poor's, which has rated Connie Lee's claims-paying ability "AAA" each year since 1991. In reaffirming Connie Lee's rating in May 1995, Standard and Poor's said Connie Lee's AAA rating is based on Connie Lee's very strong ratio of capital resources to insurance in force, stable financial performance, pragmatic strategic and business planning, and proven underwriting practices.

In Standard and Poor's May 1995 ranking of the 10 major municipal bond insurers, however, it most often ranked Connie Lee seventh or below in 16 performance categories assessed. But Standard and Poor's noted that Connie Lee's rankings, compared with the other companies, reflect that it is (1) a new insurer and, therefore, suffers from the disproportionately high expense base of a start-up company; (2) a small company; and (3) an insurer restricted to the higher-education sector of the bond market.

During 1992, the first full year that Connie Lee insured bonds, and continuing into 1993, falling interest rates sparked an increase in bond refinancing that caused the volume of municipal bond insurance and profits to surge throughout the bond insurance industry. However, as interest rates increased in 1994, the overall municipal bond and associated insurance volume dropped, as bond refinancing significantly decreased, causing profits to decline industrywide. Connie Lee's net premiums written declined 36 percent in 1994, after having increased 148 percent in 1992 and decreased 22 percent in 1993. But net premiums written fell 29 percent for municipal bond insurers as a whole in 1994, after having increased 25 percent in 1993.

Despite this, Connie Lee's key financial indicators have shown positive trends. As reflected in Connie Lee's audited financial statements, as of December 31, 1994, Connie Lee's total insurance in force was $6.6 billion, an increase of 25 percent since December 31, 1992. For the year ended December 31, 1994, Connie Lee's total revenue was $19.7 million, an increase of 8 percent since the end of 1993. Total revenue had shown an increase of 18 percent during 1993. Net income for 1994 was $8 million, an increase of only 9 percent over 1993, although the increase from 1992 to 1993 was 27 percent. Connie Lee's total assets rose 3 percent between 1993 and 1994, totaling $225 million on December 31, 1994. Total assets had shown an increase of 13 percent during 1993.

In 1994, Connie Lee reported its return on equity as 5.6 percent and its return on assets as 3.6 percent. Both indicators rose slightly in 1994, but both are below estimates of the industry averages, as reported by industry analysts, which were 13.7 percent for return on equity and 5.3 percent for return on assets.

At the end of 1994, Connie Lee held $1 in capital for every $57 of exposure to loss, that is, every $57 it was obligated to pay in case of defaults, whereas the average for the industry as a whole was $1 of capital for every $134 of exposure to loss. Since its inception, Connie Lee has not incurred any losses from bond defaults. However, in 1994, Connie Lee set up a loss reserve of $1.5 million to cover potential losses due to the default of a hospital it reinsured.

According to Standard and Poor's and other industry analysts, the amount of capital held by bond insurers is so far in excess of minimum levels required to maintain a AAA rating that it represents a problem for the industry—too much idle capital. Because of the slowdown in the bond market and associated bond insurance business, Standard and Poor's is urging municipal bond insurers to put unutilized capital to use by opening new lines of business instead of lowering premiums or insuring riskier projects. Among the new lines of business that Standard and Poor's suggests are investment management services and international insurance. But Connie Lee's authorizing legislation restricts it from expanding into new lines of business.

Scope and Methodology

To develop information for this report, we reviewed federal and state laws applicable to the authorization and establishment of Connie Lee, and Connie Lee's legislative history. We also reviewed literature on Connie Lee and the bond insurance industry.

We interviewed officials at Connie Lee to determine its policies and practices for obtaining and approving applications for bond insurance and its suggestions that would enable it to better serve more schools. We also collected data on the colleges, universities, and teaching hospitals that were either approved or rejected—from October 29, 1991, through June 30, 1995—by Connie Lee for bond insurance. We analyzed the data on the schools Connie Lee approved for insurance. In addition, we obtained information and collected data on Connie Lee's financial record and profitability through December 1994, as reported in Connie Lee's audited financial statements. We did not assess Connie Lee's financial condition, but instead relied on Standard and Poor's credit analysis. Nor did we independently verify the information provided by Connie Lee or others.

We interviewed officials in a judgmentally selected sample at HBCUs and other schools that had applied to Connie Lee for bond insurance. We included schools that had obtained insurance from Connie Lee and those that had not. We also interviewed representatives of the bond insurance industry, Standard and Poor's, and the Department of Education.

We did not assess the extent of needed construction and renovation among colleges, universities, and teaching hospitals. We also did not determine the number of schools for which Connie Lee might be an appropriate vehicle for helping to finance facilities' construction and renovation.

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

OCT 18 1995

Mr. Joseph Eglin
General Accounting Office
Washington, D.C. 20548

Dear Mr. Eglin:

This letter responds to your request for comments on the General Accounting Office draft report entitled, "Financing College Facilities: Factors Limit Connie Lee's Ability to Help More Schools," dated October 1995 (GAO/HEHS-96-6). At the request of Congressman William Clay, the GAO report on Connie Lee describes the extent to which Connie Lee has served the needs of schools, especially HBCUs, by insuring municipal bonds issued to finance the construction and renovation of academic facilities, HBCUs' views on alternatives to Connie Lee for serving such needs, and Connie Lee's views on changes that might enable it to better serve HBCUs. We do not disagree with the reporting of the status of the Connie Lee program. We would note that the GAO report does not make specific recommendations and does not assess the feasibility of suggestions made by Connie Lee to serve more schools for our comment.

Please also note that the Administration believes full privatization of Connie Lee is in the best interest of the Government and of Connie Lee--a position with which Connie Lee concurs. An Administration legislative proposal, the "College Construction Loan Insurance Association Privatization Act of 1995" is currently pending before Congress. This bill would repeal Part D of Title VII of the Higher Education Act, which authorizes Connie Lee, and would remove statutory restrictions on Connie Lee's operations. The bill would permit market forces to operate freely by allowing Connie Lee to operate its insurance and reinsurance business without government-imposed benefits or constraints.

The GAO report does mention the Department of Education's HBCU Capital Financing Program, administered by the Office of Postsecondary Education. The HBCU Capital Financing Program provides a Federal guarantee for private-sector bond financing for the repair and construction of facilities at HBCUs. Unlike other facilities programs administered by the Department, budget authority is not requested for bond subsidies because the subsidy costs are estimated to be zero. Borrower interest rates must be sufficient to meet bond repayments and 10 percent of loan capital must be deposited in an escrow account to cover potential defaults. We will be submitting a detailed report on the HBCU Capital Financing Program to the House and Senate Appropriations Committees and will forward a copy of this report to GAO for your information.

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-5100

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In addition to this program, the Office of Postsecondary Education also administers the Title III-B Strengthening HBCUs program, the Strengthening Historically Black Graduate Institutions (HBGIs) Program and the Title III-C Endowment Program that can assist HBCUs in financing construction and renovation of academic facilities. The Title III-B Strengthening HBCUs and HBGIs programs are designed to help HBCUs support operations, academic improvements, and endowments. The Endowment program allows HBCUs to establish or increase institutional endowment funds. The interest earned from this endowment can be used on any institutional expenses including construction, maintenance, renovation, and improvement in facilities.

If you have any questions or require further information, please contact my office

Sincerely,

David A. Longanecker

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